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ABSTRACT

The practice of providing financial incentives in higher education to reduce costs through improved managerial practices is discussed. It is suggested that for a state to adopt incentives in its budgetary practices affecting public higher education, several factors are required: the institutions, the legislature, gubernatorial staff, and the state higher education agency should agree on the nature and impact of the proposed budgetary provisions; and key individuals must initiate the change and serve as brokers between legislative or gubernatorial interests and the interests of higher education. Budgetary practices that are being implemented as a partial remedy for the financial plight of their public colleges include: retention of indirect cost recoveries, institutional control over tuition policies, and managerial flexibility. Colorado and Kentucky have made big changes in the authority and responsibility given to governing boards for business management of the institutions. Two studies examining state budgetary changes for improving higher education are being conducted by the Education Commission of the States and the National Association of College and University Business Officers. (SW)

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21. Improving Higher Education Through Budget Incentives

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21. Improving Higher Education Through Budget Incentives

The Issue

Two current, major issues in public higher education are (1) how to improve or maintain the quality of education and (2) how to finance state higher education goals. Prospects are dim in many states for increasing the real dollar amount spent for higher education. Revenues will have to come from other sources or higher education institutions will need to become more efficient or contract their scale of operations. The net result must be better use of fewer state dollars.

One solution receiving attention is to provide financial incentives to reduce costs through improved managerial practices. Experience shows that, in the long run, legislative intervention to achieve operational efficiencies in higher education is of dubious value. General legislative inducements, however, which leave specific implementation strategies in the hands of the institutions, may prove more effective and efficient in the long run.

Conditions for Change

For a state to adopt incentives in its budgetary practices affecting public higher education, several factors are required:

- All concerned parties -- the institutions, the legislature, the state higher education agency and gubernatorial staff -- should agree on the nature and impact of the proposed budgetary provisions. Failure to include all concerned parties or to understand the implications of the proposed change may give rise to frustrations that will subsequently undermine the constructive efforts for change.

- Key individuals must initiate the change and serve as brokers between legislative or gubernatorial interests and the interests of higher education.

Changes will differ by state due to differences in the historical context of higher education in the state, the governance structure, demographic, fiscal and political considerations, the state goals for education, and past budgetary practices in higher education. Some states (for example, Iowa, Michigan, Tennessee, Utah and Wisconsin) already provide extensive budgetary flexibility to public institutions of higher education. In other states change may be difficult to achieve. In Maryland, for example, a key impediment to making progress toward budget control change is the existence of a credibility gap between the legislature and the higher education community. If there were an agreement regarding education needs, the level of budget justification required would probably be reduced.

An impetus for change in the budget provisions in nearly all states, however, is state revenue shortfalls. Budget cuts and mid-year rescissions support contentions of colleges and universities that they need more fiscal flexibility and autonomy to adapt more easily to budget constraints and to operate more efficiently. This situation can be found among all regions of the country. Even the oil and gas states in the South, having prospered during the past decade, foresee state revenues declining because of the current energy glut and price decline.

Budgetary Incentives

Several budgetary practices are being adopted or proposed by various states as a partial remedy for the financial plight of their public colleges and universities.

Retention of indirect cost recoveries. Retention of indirect cost recoveries is a provision that many institutions, especially those engaged in research, advocate. An institution conducts sponsored research, service, instruction and other projects that are funded by federal and private sources. A state may recognize and budget

direct costs from sponsored activities as additional revenue for undertaking additional work but offset indirect costs of sponsored activities through a reduction of state appropriations for administrative and general support. Allowing an institution to retain part of the indirect encourages it to seek additional non-state revenue. The following are examples of what states are doing.

- In North Carolina, the institutions of the University of North Carolina are allowed to retain 70 percent of all overhead receipts collected on research projects. Prior to 1980, they were allowed to retain only 50 percent.

- In Minnesota, the retention policy is becoming more favorable for higher education. In the past all indirect cost recoveries were offset against state appropriations. Four years ago, the University of Minnesota was allowed to retain 2 1/2 percent. For FY 1984 the governor is proposing that only the indirect on the first 11 million dollars of contracts and grants be offset, with any additional funds being retained by the university. This proposal represents a substantial improvement over the 2 1/2 percent provision.

- In Georgia, the Study Committee on Public Higher Education Finance recommended that institutions be allowed to retain 70 percent of their indirect cost recoveries to compensate for their increased workload and subsequently to increase the rate further to 85 percent as an incentive to attract sponsored research funding.

Tuition policies. Another category of budgetary change is institutional control over tuition policies. However, progress is slow. State legislatures are often reluctant to relinquish control over tuition policies because (1) they fear that institutions will raise tuition levels too quickly and (2) they wish to maintain a fixed relationship between average expenditures per student and the charge assessed the student. The primary concern of most legislatures regarding tuition policy is establishing it as a percentage of average student cost. Nevertheless some states have given to institutions some flexibility for setting tuition charges or retaining a portion of the tuition revenue.

- Tuition revenue from state colleges in New Jersey is turned over to the state treasury, but the Board of Higher Education adopted a tuition policy allowing the state colleges to retain each year additional revenue generated from tuition increases.

- Colleges and universities in Colorado are able to set their own tuition levels and to retain tuition revenue as long as the tuition for out-of-state students is at least three times as much as for in-state students.

- An idea proposed by a community college in Massachusetts is to allow it to retain all tuition revenue. Currently, tuition revenue goes into the state general fund. Under the proposal, the state appropriation for the college would be reduced by the amount of the current tuition revenue, but the community college would then gain additional revenue if it were to increase enrollments. It is too early to estimate the likelihood of acceptance by either the Board of Regents or the legislature, but the idea is an indication of what higher education institutions are considering.

- Institutions in Maryland have proposed that general funds be dispersed quarterly, directly to the institutions. Currently, all expenditures go through the state treasury. Under the proposal, the institutions would be able to earn interest on the disbursements. While the state would likely offset its appropriation by the amount of interest it foregoes, the institutions might still accept the proposal for the flexibility of money management it would provide. The proposal is seen by some as too remedial.

Managerial flexibility. Colorado and Kentucky have made big changes in the authority and responsibility given to governing boards for business management of the institutions.

- Colorado. Colorado made a comprehensive change in budgeting provisions which gives the public colleges and universities fiscal autonomy and incentives to control their costs. Beginning in fiscal year 1982, governing boards of institutions were given authority to set their own tuition levels and to retain the tuition revenue, to carry funds forward from one year to the next, to receive their appropriation as a lump sum rather than according to specified line items, and to transfer funds between campuses of an institution and between institutions under the same governing board. Previously, the legislature had authority over these practices. Although this new provision for institutional autonomy and flexibility has not been established for long, the Colorado experience is generally viewed favorably by the institutions and the legislature. However, criticism is beginning to rise about the level of financial support provided by the legislature. The provision by the legislature of greater autonomy is seen by some as a trade-off for lower state funding of Colorado public higher education.

- Kentucky. The key conclusion of a consultant's management study of public higher education, requested by the governor, was that state rules and regulations and bureaucratic procedures posed the biggest obstacle to the improvement of management at colleges and universities. The "Universities Management Bill" passed in 1982 eliminated much of the centralization of management that had occurred over several years. The bill granted each governing board authority to make

its own purchases, select and contract with architects for capital construction, acquire and dispose of real property, employ fiscal agents to prepare and sell bond issues, undertake certain accounting functions, and write payroll checks. Each institution has the option to elect all or any number of the provisions of the bill. Initial reaction by the legislature, governor's office and higher education to these changes is favorable.

Examples of other efforts to establish incentives for improved efficiency or to achieve greater effectiveness through other means related to the budget include allowing a campus to retain net savings it is able to achieve during the year (Maine), setting aside a portion of the state appropriation for quality development (Tennessee), and financially rewarding quality improvement among academic disciplines for value added by graduating students (Northeastern Missouri State University).

Studies of Budgetary Incentive Programs

Two studies are examining state budgetary changes for improving higher education. One is being conducted by the Education Commission of the States (ECS) and the National Association of College and University Business Officers (NACUBO). The purpose of the project is to assist states that are considering changing their budgetary practices to provide incentives for their public colleges and universities to stretch available state resources for higher education. The project will disseminate information of various activities and proposals being undertaken by the states. As a part of the project, case studies have been or will be made of the experiences in Colorado, Connecticut, Kentucky and Washington.

A second project is identifying what states are doing to improve the quality of postsecondary education through state policy and budget practices. Case studies will also be a part of this project. State visits have been made or will be made to Florida, Indiana, New Jersey, Tennessee and Virginia.

For additional information about the first project contact William Hyde at ECS, 303-830-3654, or Jim Hyatt at NACUBO, 202-861-2539. Contact John Folger at Vanderbilt University, 615-322-8544, for additional information about the other project.

What to Read

Folger, John, Financing Higher Education in Tennessee in the 1980s. Nashville, Tenn.: Vanderbilt Institute for Public Policy Studies, 1982.

Hyde, William, Providing Public Colleges and Universities More Fiscal Autonomy: The Experience in Colorado. Denver, Colo.: Education Commission of the States, 1983.

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